

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name		County
Fiscal Year End	Opinion Date		Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).


YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name)		Telephone Number		
Street Address		City	State	Zip
Authorizing CPA Signature 		Printed Name		License Number

City of Mt. Morris, Michigan

**Financial Report
with Supplemental Information
June 30, 2007**

City of Mt. Morris, Michigan

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City of Mt. Morris, Michigan

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Independent Auditor's Report

To the City Council
City of Mt. Morris, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Mt. Morris, Michigan (the "City") as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Mt. Morris, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Mt. Morris, Michigan as of June 30, 2007 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the budgetary comparison schedules, as identified in the table of contents, are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the City Council
City of Mt. Morris, Michigan

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Mt. Morris, Michigan's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moreau, PLLC

October 30, 2007

City of Mt. Morris, Michigan

Management's Discussion and Analysis

Using this Annual Report

The annual report consists of a series of narratives and financial statements. This narrative is intended to serve as an introduction to the City of Mt. Morris' (the "City") basic financial statements. The basic financial statements consist of three components: government-wide financial statements, fund financial statements, and the notes to the financial statements. This report also contains other supplemental information.

The format of the annual report was modified in 2004 to comply with the reporting requirements of Government Accounting Standards Board Statement No. 34. The basic financial statements include two kinds of statements that present different views of the City. The statement of net assets and the statement of activities provide information about the activities of the City on a government-wide basis. They are designed to present a long-term view of the City's finances. The fund financial statements, which follow the above-mentioned statements, illustrate how the services provided by the City were financed in the short term, as well as what remains for future spending. Additionally, the fund financial statements report the City's operations in more detail than the government-wide financial statements.

Government-wide Statements

The government-wide statements provide information about the City as a whole, using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the City's assets and liabilities. Net assets, the difference between the City's assets and liabilities, are one way to measure the City's overall financial health. The statement of activities reflects all of the current year's revenues and expenses, regardless of when cash is actually received or paid.

The government-wide financial statements of the City are divided into three categories:

- **Governmental activities** - Most of the City's basic services are included here such as police, fire, public works, recreation, and general administration. Property taxes, state-shared revenues, charges for services, and grants provide the majority of the funding.
- **Business-type activities** - The City charges user fees to customers to cover costs of providing water and sewer services.
- **Component unit** - Downtown Development Authority (DDA) activities - The DDA has a separate property tax millage to properly develop and upkeep designated areas within the City.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds, not the City as a whole. Funds are accounting tools that the City uses to keep track of specific sources of funding or monitor spending. Some funds are required to be separately maintained by state law. The City Council establishes other funds to control and manage money for particular purposes.

The City has three kinds of funds:

- Governmental funds - Most of the City's basic services are included in governmental funds, which focus on how cash, and other financial assets that can be converted to cash, flow in and out, and the balance left at year end that is available for future spending. The governmental fund statements provide a detailed short-term view that highlights whether there are more or fewer financial resources available in the near future to finance the City's programs. Because the focus of governmental funds is narrower, it is useful to compare this information with similar information presented for governmental activities in the government-wide financial statements. Both the balance sheet and the statement of revenues, expenditures, and changes in fund balance for the governmental funds provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains eight individual governmental funds. Information is presented separately in the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balances for the General Fund, Housing Development Grant Fund, and Major Streets Fund, all of which are considered to be major funds. Data for the other five governmental funds is combined into a single, aggregated presentation. Individual fund data for the nonmajor governmental funds is provided in the form of combining statements located in the other supplemental information section of this report.

The City adopts an annual appropriated budget for all of its governmental funds. Budgetary comparison statements have been provided for all major governmental funds to demonstrate budgetary compliance.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

- Proprietary funds - Proprietary fund reporting, like government-wide statements, provide both short-term and long-term financial information. The City maintains two different types of proprietary funds. Enterprise Funds are used to report the same functions presented in the business-type activities in the government-wide financial statements. The City uses an Enterprise Fund to account for its water and sewer operation. This fund is considered a major fund of the City. Internal Service Funds accumulate and allocate costs internally among various functions. The City uses an Internal Service Fund to account for its retiree benefit expenditures. Because these programs predominantly benefit governmental rather than business-type functions, they have been consolidated within the governmental activities in the government-wide financial statements.
- Fiduciary funds - Fiduciary funds are used to account for resources held for the benefit of parties outside of the City. Fiduciary funds are not reflected in the government-wide financial statements because the resources held in those funds are not available to finance the City's programs.

Notes to the Financial Statements

Notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the government-wide and fund financial statements.

Required Supplemental Information

The required supplemental information is in addition to the basic financial statements and accompanying notes. This section of the report highlights the City's progress in funding its obligations to provide pension and other postemployment benefits to its employees. In addition, this section includes the budgetary comparison statements for the General Fund and major Special Revenue Funds.

Other Supplemental Information

The combining fund statements referred to earlier, as well as the City's combining Internal Service Funds, are presented immediately following the required supplemental information section of this report.

The City of Mt. Morris, Michigan as a Whole

The City's combined total net assets are approximately \$3.5 million. Looking at the governmental activities, separate from the business-type activities, you can see that the governmental activities experienced an increase of approximately \$200,000 in net assets. This was the result of careful budgeting. Business-type activities remained relatively unchanged from a year ago.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

In a condensed format, the table below shows the comparison of net assets (in millions of dollars) as of June 30, 2007 to the prior year:

TABLE I

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
Assets						
Current assets	\$ 0.9	\$ 0.8	\$ 0.5	\$ 0.5	\$ 1.4	\$ 1.3
Noncurrent assets	<u>2.5</u>	<u>2.7</u>	<u>3.3</u>	<u>3.2</u>	<u>5.8</u>	<u>5.9</u>
Total assets	3.4	3.5	3.8	3.7	7.2	7.2
Liabilities						
Current liabilities	0.2	0.4	0.2	0.1	0.4	0.5
Long-term liabilities	<u>2.3</u>	<u>2.4</u>	<u>1.0</u>	<u>1.1</u>	<u>3.3</u>	<u>3.5</u>
Total liabilities	<u>2.5</u>	<u>2.8</u>	<u>1.2</u>	<u>1.2</u>	<u>3.7</u>	<u>4.0</u>
Net Assets						
Invested in capital assets -						
Net of related debt	0.7	0.7	2.2	2.1	2.9	2.8
Restricted	0.6	0.5	0.1	0.1	0.7	0.6
Unrestricted	<u>(0.4)</u>	<u>(0.5)</u>	<u>0.3</u>	<u>0.3</u>	<u>(0.1)</u>	<u>(0.2)</u>
Total net assets	<u>\$ 0.9</u>	<u>\$ 0.7</u>	<u>\$ 2.6</u>	<u>\$ 2.5</u>	<u>\$ 3.5</u>	<u>\$ 3.2</u>

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

The following table shows the changes of the net assets (in millions of dollars) for the year ended June 30, 2007:

Table 2

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
Revenue						
Program revenue:						
Charges for services	\$ 0.4	\$ 0.4	\$ 1.2	\$ 1.2	\$ 1.6	\$ 1.6
Operating grants and contributions	0.2	0.2	-	-	0.2	0.2
Capital grants and contributions	-	-	-	-	-	-
General revenue:						
Property taxes	0.9	0.7	-	-	0.9	0.7
State-shared revenue	0.4	0.4	-	-	0.4	0.4
Miscellaneous	0.2	0.2	0.1	-	0.3	0.2
Total revenue	2.1	1.9	1.3	1.2	3.4	3.1
Program Expenses						
General government	0.5	0.5	-	-	0.5	0.5
Public safety	0.9	0.9	-	-	0.9	0.9
Public works	0.5	1.2	-	-	0.5	1.2
Interest on long-term debt	-	0.1	-	-	-	0.1
Water and sewer	-	-	1.2	1.2	1.2	1.2
Total program expenses	1.9	2.7	1.2	1.2	3.1	3.9
Change in Net Assets	\$ 0.2	\$ (0.8)	\$ 0.1	\$ -	\$ 0.3	\$ (0.8)

Governmental Activities

In fiscal year 2007, the revenues for the City's governmental activities increased slightly due to the Downtown Development Authority (DDA) refunding the Tax Increment Financing Act monies, which had not been used. They refunded approximately 2 ½ years worth of capture to the local taxing authorities, including the City.

In fiscal year 2007, the expenditures for the City's governmental activities decreased by \$800,000 from the previous year. This was due to careful budgeting and employee retirements.

The City continued meeting the actuarial required contributions for its defined benefit pension system. This required contribution was \$144,492, a decrease of \$2,846 from the previous year.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Business-type Activities

The City has one business-type activity, the Water and Sewer Fund. Water and sewer operations are funded directly by user fees or charges for services. Revenues of the City's Water and Sewer Fund exceeded expenses by approximately \$85,000, meaning the Enterprise Fund ended the year with a net operating income.

In fiscal year 2003, the City revised the water and sewer rate structure. The revised water and sewer rate structure serves to better isolate the effects of cost increases to the City and to become more compliant with state regulations. The City will be reviewing the water and sewer rates periodically to ensure the rates are covering the costs of the system.

The City's Funds

The analysis of the City's major funds follows the government-wide financial statements. The fund financial statements provide detailed information about the most significant funds, not the City as a whole. The City Council creates funds to help manage money for specific purposes as well as to show accountability for certain activities, such as State of Michigan Act 51 major and local road revenue sharing. The City's major funds for 2007 include the General Fund, Housing Development Grant Fund, and the Major Streets Fund.

The General Fund pays for most of the City's governmental services. The most significant of these is public safety, which incurred expenditures of approximately \$897,000. The general operating millage levied by the City helps supports these two services. The Major Streets Fund is used by the City to account for capital outlay expenditures related to road construction and maintenance. State revenue sources and transfers from other funds support the activity in this fund. Lastly, the Housing Development Grant Fund is a grant given to the City from HUD and loaned out to a developer.

General Fund Budgetary Highlights

Over the year, City administration and the City Council monitor and amend the budget to take into account unanticipated events that occur during the year. The most significant of these events during fiscal year 2007 were payouts to employees who retired. To combat other dismal revenue increases and continued healthcare and pension funding increases, the City exercised increased diligence in the area of expenditure control. In addition, the City continued to assess other governmental funds an administrative charge for services provided by the General Fund. As a result, actual revenues and expenditures approximated final budgeted amounts within most categories.

During the fiscal year, the budget was amended in a legally permissible manner.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Capital Assets and Long-term Debt Administration

At the end of fiscal year 2007, the City had approximately \$4.4 million invested in a wide range of capital assets, including land, buildings, police and fire equipment, computer equipment, and water and sewer lines.

In addition, the City had approximately \$2.5 million in debt obligations related to general obligation bonds, installment purchase obligations, and revenue bonds.

Economic Factors and Next Year's Budgets and Rates

The City has prepared its budget to incorporate the continued decrease in state-shared revenue and the limited growth in existing property tax values due to restrictions of Proposal A and Headlee limitations. Both of these significant revenue sources will continue to have a negative impact on 2008 General Fund revenue. The City is facing very challenging financial times and will be developing a three- to five-year operational and capital plan.

In fiscal year 2003, the City restructured the water and sewer rates for the Water and Sewer Fund to conform to local and state regulations. The City will need to continue to revise its rates in order to address future costs and needs of the system.

Contacting the City's Management

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the City's office.

City of Mt. Morris, Michigan

Statement of Net Assets June 30, 2007

	Primary Government			Component Unit - DDA
	Governmental Activities	Business-type Activities	Total	
Assets				
Cash and investments (Note 3)	\$ 739,867	\$ 189,488	\$ 929,355	\$ 28,985
Receivables:				
Customer	12,537	147,469	160,006	-
Special assessment - Net of allowance for doubtful accounts of \$724,474	-	-	-	-
Housing Development receivable (Note 4)	1,000,000	-	1,000,000	-
Due from other governmental units	167,892	-	167,892	-
Due from component unit	795	-	795	-
Internal balances	7,882	(7,882)	-	-
Other	7,983	-	7,983	-
Inventories, prepaids, and other assets	-	31,686	31,686	-
Land held for resale	355,663	-	355,663	-
Restricted assets (Note 8)	-	149,982	149,982	-
Capital assets - Net (Note 5):				
Nondepreciable capital assets	642,126	18,744	660,870	40,000
Depreciable capital assets - Net	542,646	3,232,890	3,775,536	62,900
Total assets	3,477,391	3,762,377	7,239,768	131,885
Liabilities				
Accounts payable	57,187	57,739	114,926	-
Accrued and other liabilities	61,829	26,627	88,456	-
Due to primary government	-	-	-	795
Deferred revenue (Note 4)	1,000,000	-	1,000,000	-
Noncurrent liabilities (Note 7):				
Due within one year	98,772	109,441	208,213	-
Due in more than one year	1,336,286	980,581	2,316,867	-
Total liabilities	2,554,074	1,174,388	3,728,462	795
Net Assets				
Invested in capital assets - Net of related debt	706,247	2,161,612	2,867,859	102,900
Restricted:				
Streets and highways	390,777	-	390,777	-
Cemetery care	66,733	-	66,733	-
Other	42,857	-	42,857	-
Special assessment debt service	147,073	-	147,073	-
Water and sewer debt service	-	149,982	149,982	-
Unrestricted	(430,370)	276,395	(153,975)	28,190
Total net assets	\$ 923,317	\$ 2,587,989	\$ 3,511,306	\$ 131,090

City of Mt. Morris, Michigan

	Program Revenues		
	Charges for	Operating	Capital Grants
Expenses	Services	Grants and Contributions	and Contributions
Functions/Programs			
Primary government:			
Governmental activities:			
General government	\$ 486,897	\$ 58,090	\$ 3,775
Public safety	920,263	106,454	7,525
Public works	457,703	239,584	198,125
Recreation and culture	24,487	-	-
Interest on long-term debt	36,594	-	-
Total governmental activities	1,925,944	404,128	209,425
Business-type activities - Water and sewer	1,183,535	1,157,293	-
Total primary government	<u>\$ 3,109,479</u>	<u>\$ 1,561,421</u>	<u>\$ 209,425</u>
Component unit - Downtown Development Authority	<u>\$ 179,967</u>	<u>\$ -</u>	<u>\$ -</u>
General revenues:			
Property taxes			
State-shared revenues			
Unrestricted investment earnings			
Transfers			
Miscellaneous			
Total general revenues			
Change in Net Assets			
Net Assets - Beginning of year			
Net Assets - End of year			

Statement of Activities
Year Ended June 30, 2007

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			Component Unit - DDA
Governmental Activities	Business-type Activities	Total	
\$ (425,032)	\$ -	\$ (425,032)	\$ -
(806,284)	-	(806,284)	-
(19,994)	-	(19,994)	-
(24,487)	-	(24,487)	-
(36,594)	-	(36,594)	-
(1,312,391)	-	(1,312,391)	-
-	(26,242)	(26,242)	-
(1,312,391)	(26,242)	(1,338,633)	-
-	-	-	(179,967)
853,797	-	853,797	89,750
392,638	-	392,638	-
70,337	11,238	81,575	6,479
(87,532)	87,532	-	-
261,752	12,507	274,259	-
1,490,992	111,277	1,602,269	96,229
178,601	85,035	263,636	(83,738)
744,716	2,502,954	3,247,670	214,828
\$ 923,317	\$ 2,587,989	\$ 3,511,306	\$ 131,090

City of Mt. Morris, Michigan

Governmental Funds Balance Sheet June 30, 2007

	Major Special Revenue Funds				
		Housing Development	Major Streets	Other Nonmajor	Total
	General Fund	Grant Fund	Fund	Governmental Funds	Governmental Funds
Assets					
Cash and cash equivalents (Note 3)	\$ 140,952	\$ -	\$ 316,870	\$ 281,919	\$ 739,741
Receivables:					
Customers	12,537	-	-	-	12,537
Special assessment - Net of allowance for doubtful accounts of \$724,474	-	-	-	-	-
Due from other governmental units	63,469	-	24,346	8,185	96,000
Due from component unit	795	-	-	-	795
Other	7,983	-	-	-	7,983
Due from other funds (Note 6)	12,185	-	1,000	-	13,185
Housing Development receivable (Note 4)	-	1,000,000	-	-	1,000,000
Land held for resale	355,663	-	-	-	355,663
Total assets	<u>\$ 593,584</u>	<u>\$ 1,000,000</u>	<u>\$ 342,216</u>	<u>\$ 290,104</u>	<u>\$ 2,225,904</u>
Liabilities and Fund Balances					
Liabilities					
Accounts payable	\$ 56,934	\$ -	\$ 253	\$ -	\$ 57,187
Accrued and other liabilities	41,340	-	500	357	42,197
Due to other funds (Note 6)	1,000	-	1,586	2,717	5,303
Deferred revenue (Note 4)	<u>-</u>	<u>1,000,000</u>	<u>-</u>	<u>-</u>	<u>1,000,000</u>
Total liabilities	99,274	1,000,000	2,339	3,074	1,104,687
Fund Balances					
Reserved in:					
General Fund (Note 9)	398,520	-	-	-	398,520
Cemetery Care Fund	-	-	-	66,733	66,733
Unreserved - Reported in:					
General Fund	95,790	-	-	-	95,790
Special Revenue Funds	-	-	339,877	50,900	390,777
Debt Service Funds	-	-	-	148,122	148,122
Capital Projects Fund	<u>-</u>	<u>-</u>	<u>-</u>	<u>21,275</u>	<u>21,275</u>
Total fund balances	<u>494,310</u>	<u>-</u>	<u>339,877</u>	<u>287,030</u>	1,121,217
Total liabilities and fund balances	<u>\$ 593,584</u>	<u>\$ 1,000,000</u>	<u>\$ 342,216</u>	<u>\$ 290,104</u>	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in the funds	1,184,772
State-shared revenue receivable is to be collected next fiscal year, relating to the State's sales tax year	71,892
Accrued interest payable is not due and payable in the current period and is not reported in the funds	(19,632)
Long-term liabilities are not due and payable in the current period and are not reported in the funds	(1,435,058)
Internal Service Funds are included as part of governmental activities	126
Net assets of governmental activities	\$ 923,317

City of Mt. Morris, Michigan

Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances Year Ended June 30, 2007

		Major Special Revenue Funds		Other	
		Housing		Nonmajor	Total
		Development	Major Streets	Governmental	Governmental
	General Fund	Grant Fund	Fund	Funds	Funds
Revenue					
Property taxes	\$ 775,280	\$ -	\$ -	-	\$ 775,280
Tax Incremental Financing Authority refund	81,012	-	-	-	81,012
Special assessment	-	-	-	91,925	91,925
Licenses and permits	11,340	-	-	-	11,340
Federal sources	100	-	-	-	100
State sources	404,197	-	148,279	49,846	602,322
Charges for services	225,120	-	-	-	225,120
Fines and forfeitures	51,584	-	-	-	51,584
Interest	14,423	-	13,250	42,464	70,137
Rents, royalties, and other	280,857	-	10,534	1,836	293,227
Total revenue	1,843,913	-	172,063	186,071	2,202,047
Expenditures					
General government	430,028	-	-	-	430,028
Public safety	897,112	-	-	-	897,112
Public works	280,442	-	116,032	66,242	462,716
Recreation, cultural, and other	22,557	-	-	45	22,602
Retiree health care	44,947	-	-	-	44,947
Debt service	-	-	-	121,809	121,809
Total expenditures	1,675,086	-	116,032	188,096	1,979,214
Excess of Revenue Over (Under)					
Expenditures	168,827	-	56,031	(2,025)	222,833
Other Financing Sources (Uses)					
Transfers in (Note 6)	13,124	-	-	55,626	68,750
Transfers out (Note 6)	(44,626)	-	(11,000)	-	(55,626)
Total other financing sources (uses)	(31,502)	-	(11,000)	55,626	13,124
Change in Fund Balance	137,325	-	45,031	53,601	235,957
Fund Balances - July 1, 2006	356,985	-	294,846	233,429	885,260
Fund Balances - June 30, 2007	<u>\$ 494,310</u>	<u>\$ -</u>	<u>\$ 339,877</u>	<u>\$ 287,030</u>	<u>\$ 1,121,217</u>

City of Mt. Morris, Michigan

Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities Year Ended June 30, 2007

Net Change in Fund Balances - Total Governmental Funds **\$ 235,957**

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures; in the statement of activities, these costs are allocated over their estimated useful lives as depreciation	(50,931)
Revenue reported in the statement of activities that does not provide current financial resources and is not reported as revenue in the governmental funds (GASB No. 33)	(7,575)
Proceeds from the sale of capital assets reported as revenue in the governmental funds; the statement of activities recorded a gain or loss, included in miscellaneous revenue	(100)
Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt)	87,000
Interest expense is recorded when incurred in the statement of activities	(1,784)
Net decrease in accumulated employee sick and vacation pay and estimated general liability claims are recorded when earned in the statement of activities	18,726
Transfer of equipment net of related debt from Equipment Fund	79,292
Internal Service Funds are also included as governmental activities	<u>(181,984)</u>

Change in Net Assets of Governmental Activities **\$ 178,601**

City of Mt. Morris, Michigan

Proprietary Funds Statement of Net Assets June 30, 2007

	Enterprise - Water and Sewer Fund	Internal Service Funds
Assets		
Current assets:		
Cash and cash equivalents (Note 3)	\$ 189,488	\$ 126
Customer receivables	147,469	-
Inventory	31,686	-
Total current assets	368,643	126
Noncurrent assets:		
Restricted assets (Note 8)	149,982	-
Nondepreciable capital assets (Note 5)	18,744	-
Depreciable capital assets - Net (Note 5)	3,232,890	-
Total noncurrent assets	3,401,616	-
Total assets	3,770,259	126
Liabilities		
Current liabilities:		
Accounts payable	57,739	-
Due to other funds (Note 6)	7,882	-
Accrued and other liabilities	26,627	-
Current portion of long-term debt (Note 7)	109,441	-
Total current liabilities	201,689	-
Noncurrent liabilities - Long-term debt - Net of current portion (Note 7)	980,581	-
Total liabilities	1,182,270	-
Net Assets		
Invested in capital assets - Net of related debt	2,161,612	-
Restricted for debt service	149,982	-
Unrestricted	276,395	126
Total net assets	<u>\$ 2,587,989</u>	<u>\$ 126</u>

City of Mt. Morris, Michigan

Proprietary Funds Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2007

	Enterprise - Water and Sewer Fund	Internal Service Funds
Operating Revenue		
Charges for services	\$ 1,095,631	\$ 89,947
Fines and forfeitures	56,452	-
Other income	17,917	-
Total operating revenue	1,170,000	89,947
Operating Expenses		
Cost of water/sewer	483,164	-
Wages and salaries	189,593	-
Fringe benefits	150,797	-
Supplies	191	-
Operating	45,906	-
Professional services	7,925	-
Insurance	14,676	-
Rental	113,166	-
Retiree benefit payments	-	92,227
Depreciation	123,401	-
Total operating expenses	1,128,819	92,227
Operating Income (Loss)	41,181	(2,280)
Nonoperating Revenue (Expense)		
Interest income	11,238	245
Interest expense	(54,816)	-
Other expense	(100)	-
Total nonoperating revenue (expense)	(43,678)	245
Loss - Before other financing sources (uses)	(2,497)	(2,035)
Other Financing Sources (Uses)		
Transfers in (Note 6)	87,532	-
Transfers out (Note 6)	-	(179,949)
Total other financial sources (uses)	87,532	(179,949)
Change in Net Assets	85,035	(181,984)
Net Assets - Beginning of year	2,502,954	182,110
Net Assets - End of year	<u><u>\$ 2,587,989</u></u>	<u><u>\$ 126</u></u>

City of Mt. Morris, Michigan

Proprietary Funds Statement of Cash Flows Year Ended June 30, 2007

	Enterprise - Water and Sewer Fund	Internal Service Funds
Cash Flows from Operating Activities		
Receipts from customers	\$ 1,171,142	\$ 89,947
Payments to suppliers	(648,434)	(92,227)
Payments to employees	(341,381)	-
Other payments	(2,976)	-
Net cash provided by (used in) operating activities	178,351	(2,280)
Cash Flows from Capital and Related Financing Activities		
Purchase of capital assets	(7,772)	-
Repayment of advances from other funds/governmental units	25,000	-
Principal and interest paid on capital debt	(158,476)	-
Net cash used in capital and related financing activities	(141,248)	-
Cash Flows from Noncapital Financing Activities - Repayment of advances to other funds/governmental units	-	(82,133)
Cash Flows from Investing Activities - Interest received on investments	11,238	245
Net Increase (Decrease) in Cash and Cash Equivalents	48,341	(84,168)
Cash and Cash Equivalents - Beginning of year	291,129	84,294
Cash and Cash Equivalents - End of year	<u>\$ 339,470</u>	<u>\$ 126</u>
Balance Sheet Classification of Cash and Cash Equivalents		
Cash and investments	\$ 189,488	\$ 126
Restricted cash and investments	149,982	-
Total cash and cash equivalents	<u>\$ 339,470</u>	<u>\$ 126</u>
Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities		
Operating income (loss)	\$ 41,181	\$ (2,280)
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Depreciation and amortization	123,401	-
Changes in assets and liabilities:		
Receivables	1,242	-
Inventory	311	-
Accounts payable	16,183	-
Accrued and other liabilities	8,209	-
Due to other funds	(12,176)	-
Net cash provided by (used in) operating activities	<u>\$ 178,351</u>	<u>\$ (2,280)</u>

Noncash Investing, Capital, and Financing Activities - During the year ended June 30, 2007, the Equipment Fund closed and transferred capital assets of \$136,819 and long-term debt of \$49,037 to the Water and Sewer Fund.

City of Mt. Morris, Michigan

Fiduciary Fund Statement of Assets and Liabilities June 30, 2007

	<u>Trust and Agency Fund</u>
Assets - Cash and cash equivalents	\$ 35,542
Liabilities - Accrued and other liabilities	\$ 35,542

Note I - Summary of Significant Accounting Policies

The accounting policies of the City of Mt. Morris, Michigan (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City:

Reporting Entity

The City is governed by an elected seven-member council. The accompanying financial statements present the City and its component unit, an entity for which the City is considered to be financially accountable. Although blended component units are legal separate entities, in substance, they are part of the City's operations. The discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City (see discussion below for description).

Discretely Presented Component Unit - The Downtown Development Authority (DDA) was created to correct and prevent deterioration in the downtown district, encourage historical preservation, and to promote economic growth within the downtown district. The DDA's governing body, consisting of eight to 11 individuals, is selected by the mayor with City Council approval. In addition, the DDA's budget is subject to approval by the City.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

Note 1 - Summary of Significant Accounting Policies (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund, fiduciary fund, and component unit financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The following major revenue sources meet the availability criterion: state gas and weight tax revenue and interest associated with the current fiscal period. Conversely, federal grant reimbursements and state-shared revenues will be collected after the period of availability; receivables have been recorded for these, along with a "deferred revenue" liability when applicable.

Note 1 - Summary of Significant Accounting Policies (Continued)

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The City reports the following major governmental funds:

General Fund - The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. General Fund activities are financed by revenue from the general property taxes, state-shared revenue, and other sources.

Housing Development Grant Fund - The Housing Development Grant Fund is a grant given to the City from HUD to loan to a developer. The developer is to pay back the City by 2016 with no interest.

Major Streets Fund - The Major Streets Fund accounts for maintenance and improvement activities for streets designated as "major" within the City. Funding is provided through state-shared gas and weight taxes.

The City reports the following major proprietary fund:

Water and Sewer Fund - The Water and Sewer Fund is used to account for the results of operations that provide water and sewer services to citizens that are financed primarily by a user charge for the provision of those services.

Additionally, the City reports the following fund types:

Internal Service Funds - Internal Service Funds are used to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City, or to other governments, primarily on a cost-reimbursement basis.

Note 1 - Summary of Significant Accounting Policies (Continued)

Agency Funds - Agency Funds are used to account for assets held by the City in a trustee capacity. These funds are custodial in nature (assets equal liabilities) and do not involve the measurement of results of operations.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The City has elected not to follow private sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water and sewer function and various other functions of the City. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, it is the City's policy to first apply restricted resources.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of our proprietary funds relates to charges to customers for sales and services. The Water and Sewer Fund also recognizes the portion of tap fees intended to recover current costs (e.g., labor and materials to hook up new customers) as operating revenue. The portion intended to recover the cost of the infrastructure is recognized as nonoperating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Note I - Summary of Significant Accounting Policies (Continued)

Property Tax Revenue

Property taxes are levied on each July 1 on the taxable valuation of property as of the preceding December 31. Taxes are considered delinquent on September 16 of the same year, at which time penalties and interest are assessed.

The City's 2006 tax is levied and collectible on July 1, 2006 and is recognized as revenue in the year ended June 30, 2007, when the proceeds of the levy are budgeted and available for the financing of operations.

The 2006 taxable valuation of the City totaled \$44,085,728 (a portion of which is abated and a portion of which is captured by the DDA), on which taxes levied consisted of 17.8526 mills for operating purposes, resulting in \$742,409 for operating purposes. These amounts are recognized in the respective General Fund financial statements as tax revenue.

Assets, Liabilities, and Net Assets or Equity

Bank Deposits and Investments - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

All trade and property tax receivables are shown as net of allowance for uncollectible amounts.

Inventories and Prepaid Items - Inventories are valued at cost, on a first-in, first-out basis, which approximates market value.

Restricted Assets - The revenue bonds of the Enterprise Funds require amounts to be set aside for debt service principal and interest payments. These amounts have been classified as restricted assets.

Land Held for Resale - Land held for resale in the General Fund is valued at the lower of cost or market value.

Note 1 - Summary of Significant Accounting Policies (Continued)

Capital Assets - Capital assets, which include property, plant, equipment, and infrastructure assets on a prospective basis (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$500 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Water and sewer systems	20 to 50 years
Buildings and building improvements	50 years
Vehicles	5 to 8 years
Machinery, equipment, and other	5 to 10 years
Land improvements	50 years

Compensated Absences (Vacation and Sick Leave) - It is the City's policy to permit employees to accumulate earned but unused vacation pay benefits. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

Long-term Obligations - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Fund Equity - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 1 - Summary of Significant Accounting Policies (Continued)

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 2 - Stewardship, Compliance, and Accountability

Construction Code Fees - The City oversees building construction, in accordance with the State's Construction Code Act, including inspection of building construction and renovation to ensure compliance with the building codes. The City charges fees for these services. The law requires that collection of these fees be used only for construction code costs, including an allocation of estimated overhead costs. A summary of the current year activity and the cumulative shortfall generated since January 1, 2000 is as follows:

Cumulative shortfall at July 1, 2006	\$ (20,380)
Current year building permit revenue	11,340
Direct costs of construction code expenses	<u>(11,851)</u>
Cumulative shortfall at June 30, 2007	<u>\$ (20,891)</u>

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan; and money market funds. The investment policy adopted by the Council is in accordance with statutory authority.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 3 - Deposits and Investments (Continued)

The City has designated two banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all of the items described above.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$180,118 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Primary government - Bank investment pool	\$ 831,819	Not rated	N/A
Component unit - Bank investment pool	28,985	Not rated	N/A

Note 4 - Loan Receivable and Deferred Revenue - Housing Development Grant Fund

In 1985, the City of Mt. Morris received a grant to make loans for the development of Morris Square. The grant was received from Michigan State Housing Development Authority. It was loaned to Mt. Morris Square Limited Dividend Housing Association to be used as a development cost write-down. The \$1,000,000 loan is currently recorded as a loan receivable and deferred revenue. The loan agreement requires that the developer repay the loan in 2015, at the end of 30 years from the original loan date.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 5 - Capital Assets

Capital asset activity of the City's governmental and business-type activities was as follows:

	Balance July 1, 2006	Transfers	Additions	Disposals and Adjustments	Balance June 30, 2007
Governmental Activities					
Other governmental capital assets:					
Capital assets not being depreciated:					
Land	\$ 368,301	\$ -	\$ -	\$ -	\$ 368,301
Construction in progress	273,825	-	-	-	273,825
Subtotal	642,126	-	-	-	642,126
Capital assets being depreciated:					
Land improvements	178,485	-	-	-	178,485
Buildings	164,640	-	-	-	164,640
Vehicles	-	893,760	-	(20,865)	872,895
Machinery and equipment	120,859	135,615	3,195	(5,541)	254,128
Subtotal	463,984	1,029,375	3,195	(26,406)	1,470,148
Accumulated depreciation:					
Land improvements	12,513	-	3,159	-	15,672
Buildings	114,012	-	2,109	-	116,121
Vehicles	-	586,033	28,739	(20,865)	593,907
Machinery and equipment	59,666	127,458	20,119	(5,441)	201,802
Subtotal	186,191	713,491	54,126	(26,306)	927,502
Net capital assets being depreciated	277,793	315,884	(50,931)	(100)	542,646
Net other governmental capital assets	\$ 919,919	\$ 315,884	\$ (50,931)	\$ (100)	\$ 1,184,772
Internal Service Funds assets:					
Capital assets being depreciated:					
Vehicles	\$ 1,116,962	\$ (1,116,962)	\$ -	\$ -	\$ -
Machinery and equipment	135,744	(135,744)	-	-	-
Subtotal	1,252,706	(1,252,706)	-	-	-
Accumulated depreciation:					
Vehicles	673,870	(673,870)	-	-	-
Machinery and equipment	126,133	(126,133)	-	-	-
Subtotal	800,003	(800,003)	-	-	-
Net Internal Service Funds capital assets	\$ 452,703	\$ (452,703)	\$ -	\$ -	\$ -
Governmental capital assets not being depreciated	\$ 642,126	\$ -	\$ -	\$ -	\$ 642,126
Net governmental capital assets being depreciated	730,496	(136,819)	(50,931)	(100)	542,646
Net governmental activity capital assets	\$ 1,372,622	\$ (136,819)	\$ (50,931)	\$ (100)	\$ 1,184,772

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 5 - Capital Assets (Continued)

	Balance July 1, 2006	Transfers	Additions	Disposals and Adjustments	Balance June 30, 2007
Business-type Activities					
Capital assets not being depreciated:					
Land	\$ 18,744	\$ -	\$ -	\$ -	\$ 18,744
Construction in progress	-	-	-	-	-
Subtotal	18,744	-	-	-	18,744
Capital assets being depreciated:					
Buildings	10,300	-	-	-	10,300
Water and sewer system	4,949,402	-	-	-	4,949,402
Machinery, equipment, and other	109,845	223,331	7,773	(3,266)	337,683
Subtotal	5,069,547	223,331	7,773	(3,266)	5,297,385
Accumulated depreciation:					
Buildings	8,446	-	206	-	8,652
Water and sewer system	1,784,524	-	97,984	-	1,882,508
Machinery and equipment	64,778	86,512	25,211	(3,166)	173,335
Subtotal	1,857,748	86,512	123,401	(3,166)	2,064,495
Net capital assets being depreciated	3,211,799	136,819	(115,628)	(100)	3,232,890
Net capital assets	\$ 3,230,543	\$ 136,819	\$ (115,628)	\$ (100)	\$ 3,251,634

Capital asset activity for the City's component unit for the year was as follows:

	Balance July 1, 2006	Transfers	Additions	Disposals and Adjustments	Balance June 30, 2007
Component Unit					
Capital assets not being depreciated -					
Land	\$ 40,000	\$ -	\$ -	\$ -	\$ 40,000
Capital assets being depreciated -					
Land improvements	85,000	-	-	-	85,000
Accumulated depreciation - Land improvements	20,400	-	1,700	-	22,100
Net capital assets being depreciated	64,600	-	(1,700)	-	62,900
Net capital assets	\$ 104,600	\$ -	\$ (1,700)	\$ -	\$ 102,900

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 5 - Capital Assets (Continued)

Depreciation expense was charged to programs of the primary government as follows:

Governmental activities:

General government	\$ 11,014
Public safety	27,323
Public works	13,859
Recreation and culture	<u>1,930</u>

Total governmental activities	<u>\$ 54,126</u>
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Business-type activities - Water and sewer	<u>\$ 123,401</u>
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Note 6 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major Street Fund	\$ 1,586
	Nonmajor governmental funds	2,717
	Water and Sewer Fund	<u>7,882</u>
	Total General Fund	12,185
Major Streets Fund	General Fund	<u>1,000</u>
	Total	<u>\$ 13,185</u>

This balance results from the time lag between the dates that goods and services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, and payments between funds are made.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 6 - Interfund Receivables, Payables, and Transfers (Continued)

Interfund transfers reported in the fund financial statements are comprised of the following:

<u>Fund Providing Resources</u>	<u>Fund Receiving Resources</u>	<u>Amount</u>
General Fund	Nonmajor governmental funds - 1999	
	Budget Bonds Fund	\$ 44,626
Major Street Fund	Local Street Fund	11,000
Equipment Fund	General Fund	13,124
	Water and Sewer Fund	<u>87,532</u>
	Total Equipment Fund	<u>100,656</u>
	Total	<u>\$ 156,282</u>

The transfer from the General Fund to the Debt Service Fund represents the use of unrestricted resources to finance the debt of the City. The transfer from the Major Street Fund to the Local Street Fund represents the sharing of gas and weight tax revenues, in accordance with Act 51. The transfer from the Equipment Fund to the General Fund and Water and Sewer Fund represents the disbursement of the net assets of the Equipment Fund upon the dissolution of that fund during the year.

Note 7 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the City. County contractual agreements and installment purchase agreements are also general obligations of the government. Special assessment bonds provide for capital improvements that benefit specific properties, and will be repaid from amounts levied against those properties benefited from the construction. In the event that a deficiency exists because of unpaid or delinquent special assessments at the time a debt service payment is due, the City is obligated to provide resources to cover the deficiency until other resources (such as tax sale proceeds or a re-assessment of the district) are received. Revenue bonds involve a pledge of specific income derived from the acquired or constructed assets to pay debt service.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 7 - Long-term Debt (Continued)

Long-term obligation activity can be summarized as follows:

	Interest Rate Ranges	Beginning Balance	Additions (Reductions)	Ending Balance	Due Within One Year
Governmental Activities					
Other governmental obligations:					
General obligation bonds:					
1999 budget bonds:					
Amount of issue - \$550,000	4.50% -				
Maturing through 2020	5.75%	\$ 450,000	\$ (20,000)	\$ 430,000	\$ 20,000
Special assessment limited tax bond:					
Special assessment district improvements:					
Amount of issue - \$850,000	3.15% -				
Maturing through 2024	5.15%	805,000	(45,000) *	760,000	45,000
Installment purchase obligations:					
Snow plow truck:					
Amount of issue - \$125,000					
Maturing through 2011	4.90%	75,000	(10,000)	65,000	15,000
Fire truck:					
Amount of issue - \$158,000	4.00% -				
Maturing through 2015	4.60%	158,000	(12,000)	146,000	13,000
Employee compensated absences		52,784	(18,726)	34,058	5,772
Total governmental activities		1,540,784	(105,726)	1,435,058	98,772
Business-type Activities					
Revenue bonds:					
Water System Extension:					
Amount of issue - \$580,000					
Maturing through 2019	6.25%	450,000	(20,000)	430,000	20,000
Water System Bonds:					
Amount of issue - \$180,000	4.90% -				
Maturing through 2020	6.00%	150,000	(5,000)	145,000	10,000
Junior Lien Revenue Bonds:					
Amount of issue - \$417,844					
Maturing through 2020	2.50%	312,844	(20,000)	292,844	20,000
County contractual obligation -					
Genesee County Water Supply System:					
Amount of issue - \$35,000					
Maturing through 2008	4.00%	14,000	(7,000)	7,000	7,000
Installment purchase obligations:					
Rosewood Water Line:					
Amount of issue - \$250,000					
Maturing through 2013	4.875%	195,000	(25,000)	170,000	25,000
Mt. Morris Road Water Line:					
Amount of issue - \$38,000					
Maturing through 2009	3.50%	22,800	(7,600)	15,200	7,600
Sewer vector truck:					
Amount of issue - \$170,000					
Maturing through 2009	4.05%	49,037	(19,059)	29,978	19,841
Total business-type activities		1,193,681	(103,659)	1,090,022	109,441
Total business-type and governmental activities		\$ 2,734,465	\$ (209,385)	\$ 2,525,080	\$ 208,213

* This special assessment relates to a single taxpayer. The City will monitor the taxpayer's long-term ability to make special assessment payments.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 7 - Long-term Debt (Continued)

Component Unit	Interest Rate Ranges	Beginning Balance	Additions (Reductions)	Ending Balance	Due Within One Year
Downtown Development Authority					
Parking Lot Bonds:					
Amount of issue - \$85,000					
Maturing through 2007	6.29%	\$ 8,000	\$ (8,000)	\$ -	\$ -
Parking lot land contract:					
Amount of issue - \$40,000					
Maturing through 2006		7,500	(7,500)	-	-
Total component unit		<u>\$ 15,500</u>	<u>\$ (15,500)</u>	<u>\$ -</u>	<u>\$ -</u>

Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2008	\$ 93,000	\$ 61,645	\$ 154,645	\$ 109,441	\$ 50,940	\$ 160,381
2009	99,000	57,548	156,548	97,734	46,207	143,941
2010	99,000	53,379	152,379	85,000	42,042	127,042
2011	105,000	49,255	154,255	90,000	38,010	128,010
2012	91,000	45,205	136,205	90,000	33,662	123,662
2013-2017	484,000	161,995	645,995	395,000	109,192	504,192
2018-2022	355,000	52,138	407,138	222,847	16,728	239,575
2023-2025	75,000	5,369	80,369	-	-	-
Total	<u>\$ 1,401,000</u>	<u>\$ 486,534</u>	<u>\$ 1,887,534</u>	<u>\$ 1,090,022</u>	<u>\$ 336,781</u>	<u>\$ 1,426,803</u>

Note 8 - Restricted Assets

Restricted assets of the Enterprise Fund include \$149,982 restricted for debt payments on the water supply and sewage disposal system revenue bonds at June 30, 2007.

Note 9 - Reserved Fund Balance

Fund balance has been reserved within the governmental funds for the following:

	Drug Forfeiture	PEG Grants	Solid Waste	Land Held for Resale	Total Reserved Fund Balance
General Fund	<u>\$ 4,869</u>	<u>\$ 18,639</u>	<u>\$ 19,349</u>	<u>\$ 355,663</u>	<u>\$ 398,520</u>

Note 10 - Risk Management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical benefits provided to employees and participates in the Michigan Municipal League (MML) risk pool for claims relating to property loss, torts, errors and omissions, and employee injuries. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

The Michigan Municipal League risk pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Note 11 - Defined Benefit Pension Plan

Plan Description - The City participates in the Genesee County Employees' Retirement System (the "System"), an agent multiple-employer defined benefit pension plan that covers all employees of the City. The System provides retirement, disability, and death benefits to plan members and their beneficiaries. The Genesee County Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the System. That report may be obtained by contacting the System at 1101 Beach St., Flint, MI 48502.

Funding Policy - The City is required to contribute at an actuarially determined rate; the current rate is 18.76 percent of annual covered payroll. City employees are required to contribute 5 percent of their annual covered payroll. The contribution requirements of the City are established and may be amended by the Retirement Board of Genesee County Employees' Retirement System. The contribution requirements of plan members are established and may be amended by the City, depending on the Genesee County Employees' Retirement System contribution program adopted by the City.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2007

Note 11 - Defined Benefit Pension Plan (Continued)

Annual Pension Cost - For the year ended June 30, 2007, the City's annual pension cost of \$144,492 for the plan was equal to the City's required and actual contribution. The annual required contribution was determined as part of the actuarial valuations at December 31, 2005. The actuarial valuations use the entry age actuarial cost method. Significant actuarial assumptions used include (a) an 8 percent investment rate of return, (b) projected salary increases of 5.00 percent to 9.03 percent per year depending on age, attributable to seniority/merit, and (c) the assumption that benefits will increase 2.5 percent per year annually after retirement. Both (a) and (b) include an inflation component of 5.00 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is amortized over a period of 20 years.

	Fiscal Year Ended June 30		
	2007	2006	2005
Annual pension cost (APC)	\$ 144,492	\$ 147,338	\$ 102,813
Percentage of APC contributed	100%	100%	100%
Net pension obligation	-	-	-
	Actuarial Valuation as of December 31		
	2006	2005	2004
Actuarial value of asset	\$ 3,807,588	\$ 3,441,373	\$ 3,237,299
Actuarial accrued liability (AAL)			
(entry age)	\$ 4,720,212	\$ 4,389,058	\$ 4,230,351
Unfunded AAL (UAAL)	\$ (912,624)	\$ (947,685)	\$ (993,052)
Funded ratio	81%	78%	77%
Covered payroll	\$ 776,749	\$ 879,914	\$ 851,850
UAAL as a percentage of covered payroll	117%	108%	117%

Note 12 - Other Postemployment Benefits

The City provides life and healthcare benefits to all full-time employees upon retirement, in accordance with labor contracts. Currently, nine retirees are eligible. The City includes pre-Medicare retirees and their dependents in its insured healthcare plan. Expenditures for postemployment healthcare benefits are recognized as the insurance premiums become due; during the year, this amounted to \$92,227. These benefits are paid annually from the Internal Service Fund.

Upcoming Reporting Change - The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any “other” postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid. The new pronouncement is effective for the year ending June 30, 2010.

Note 13 - Subsequent Event

Subsequent to June 30, 2007, a developer defaulted on its special assessment obligation. The entire receivable from the developer had been fully allowed for in the June 30, 2006 financial statements. As a result of the default, land with a taxable value of approximately \$140,700 was transferred from the developer to the City.

Required Supplemental Information

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2007

	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Resources (Inflows)				
Property taxes	\$ 774,000	\$ 844,012	\$ 856,292	\$ 12,280
Licenses and permits	28,000	13,500	11,340	(2,160)
Federal sources	-	-	100	100
State sources	413,500	403,500	404,197	697
Charges for services	214,760	224,515	225,120	605
Fines and forfeitures	76,000	47,700	51,584	3,884
Interest, rent, and other	136,200	260,750	295,280	34,530
Operating transfers in	1,500	13,124	13,124	-
Total resources (inflows)	1,643,960	1,807,101	1,857,037	49,936
Expenditures				
Legislative	17,442	10,850	10,397	453
General government:				
Elections	5,475	3,430	3,424	6
Assessor	14,250	12,596	12,595	1
Attorney	55,000	63,000	60,955	2,045
Administration	132,375	136,098	137,237	(1,139)
City treasurer	70,743	49,669	50,835	(1,166)
Accountant	26,000	43,000	40,349	2,651
City hall and grounds	104,899	80,863	79,029	1,834
Other city property	32,966	17,108	17,546	(438)
Cemetery	20,798	17,608	17,661	(53)
Total general government	462,506	423,372	419,631	3,741
Public safety:				
Police	707,372	791,796	793,388	(1,592)
K-9 Unit	-	2,185	1,706	479
Fire	89,954	127,117	87,572	39,545
Code enforcement	30,500	20,030	11,851	8,179
Planning commission	6,100	3,005	2,595	410
Total public safety	833,926	944,133	897,112	47,021

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund (Continued) Year Ended June 30, 2007

	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Expenditures (Continued)				
Public works:				
Public service	\$ 90,779	\$ 166,675	\$ 157,637	\$ 9,038
Sidewalks	19,456	3,300	2,663	637
Trash collection	115,571	114,650	114,181	469
Weed control	4,700	5,200	5,961	(761)
Total public works	230,506	289,825	280,442	9,383
Recreation, cultural, and other - Library	24,323	25,923	22,557	3,366
Retiree health care	30,000	45,000	44,947	53
Operating transfers out	44,626	44,626	44,626	-
Total expenditures	1,643,329	1,783,729	1,719,712	64,017
Net Change in Fund Balance	631	23,372	137,325	113,953
Fund Balance - Beginning of year	356,985	356,985	356,985	-
Fund Balance - End of year	\$ 357,616	\$ 380,357	\$ 494,310	\$ 113,953

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule Major Special Revenue Fund Year Ended June 30, 2007

	Major Streets Fund			
	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Revenue				
State sources	\$ 158,719	\$ 148,700	\$ 148,279	\$ (421)
Interest	6,000	12,000	13,250	1,250
Rents, royalties, and other	3,000	10,500	10,534	34
Total revenue	167,719	171,200	172,063	863
Expenditures				
Public works	169,448	145,777	116,032	29,745
Operating transfer out	11,000	11,000	11,000	-
Total expenditures	180,448	156,777	127,032	29,745
Net Change in Fund Balance	(12,729)	14,423	45,031	30,608
Fund Balance - Beginning of year	294,846	294,846	294,846	-
Fund Balance - End of year	<u>\$ 282,117</u>	<u>\$ 309,269</u>	<u>\$ 339,877</u>	<u>\$ 30,608</u>

City of Mt. Morris, Michigan

Notes to Required Supplemental Information June 30, 2007

Note 1 - Reconciliation of Budgeted Amounts to Basic Financial Statements

The budgetary comparison schedules for the General and Major Special Revenue Funds are presented on the same basis of accounting used in preparing the adopted budget. Following is a reconciliation of the budgetary comparison schedule to the governmental funds (statement of revenue, expenditures, and changes in fund balances):

	General Fund		Major Streets Fund	
	Total Revenue	Total Expenditures	Total Revenue	Total Expenditures
Amounts per operating statement	\$ 1,843,913	\$ 1,675,086	\$ 172,063	\$ 116,032
Operating transfers budgeted as revenue and expenditures	13,124	44,626	-	11,000
Amounts per budget statement	<u>\$ 1,857,037</u>	<u>\$ 1,719,712</u>	<u>\$ 172,063</u>	<u>\$ 127,032</u>

Note 2 - Budgetary Information

Budgetary Information - Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America for the General Fund and all Special Revenue Funds except that operating transfers and debt proceeds have been included in the "revenue" and "expenditures" categories, rather than as "other financing sources (uses)." All annual appropriations lapse at fiscal year end. During the year, the budget was amended in a legally permissible manner.

City of Mt. Morris, Michigan

Notes to Required Supplemental Information June 30, 2007

Note 2 - Budgetary Information (Continued)

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. On or before the first Monday in May, the treasurer and the City manager prepare a proposed operating budget for the fiscal year commencing July 1 and submit it to the City Council. The budget must be adopted through a passage of a budget resolution no later than the second Monday in June.
2. Public hearings are conducted to obtain citizen comments.
3. The legislative budget is adopted by department and fund on an activity basis. Line item detail is provided as a general guideline. Throughout the year, the Council receives requests to amend the activity budget. All amendments over \$5,000 must be approved by a vote of the City Council. Amendments to the budget under \$5,000 and changes in line items within an activity may be approved by the City manager.

Other Supplemental Information

City of Mt. Morris, Michigan

Other Supplemental Information Combining Balance Sheet Nonmajor Governmental Funds June 30, 2007

	Special Revenue Funds	Debt Service Funds	Capital Project Fund	Permanent Fund	
	Local Streets	1999 Budget Bonds	Special Assessment Debt Service Fund	Special Assessment Fund	Cemetery Care
					Total Nonmajor Governmental Funds
Assets					
Cash and cash equivalents	\$ 44,487	\$ 1,699	\$ 147,073	\$ 21,275	\$ 67,385
Due from other governmental units	8,185	-	-	-	-
Total assets	<u>\$ 52,672</u>	<u>\$ 1,699</u>	<u>\$ 147,073</u>	<u>\$ 21,275</u>	<u>\$ 67,385</u>
					<u>\$ 290,104</u>
Liabilities and Fund Balances					
Liabilities					
Accrued and other liabilities	\$ 357	\$ -	\$ -	\$ -	\$ -
Due to other funds	1,415	650	-	-	652
Total liabilities	1,772	650	-	-	652
					3,074
Fund Balances					
Reserved	-	-	-	-	66,733
Unreserved	50,900	1,049	147,073	21,275	-
Total fund balances	50,900	1,049	147,073	21,275	66,733
					287,030
Total liabilities and fund balances	<u>\$ 52,672</u>	<u>\$ 1,699</u>	<u>\$ 147,073</u>	<u>\$ 21,275</u>	<u>\$ 67,385</u>
					<u>\$ 290,104</u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Revenue, Expenditures, and Changes in Fund Balances - Nonmajor Governmental Funds Year Ended June 30, 2007

	Special Revenue Funds	Debt Service Funds	Special Assessment Debt Service Fund	Capital Project Fund	Permanent Fund	
	Local Streets	1999 Budget Bonds	Special Assessment Debt Service Fund	Special Assessment Fund	Cemetery Care	Total Nonmajor Governmental Funds
Revenue						
Special assessment	\$ -	\$ -	\$ 91,925	\$ -	\$ -	\$ 91,925
State sources	49,846	-	-	-	-	49,846
Interest	1,449	317	38,302	-	2,396	42,464
Other	956	-	-	-	880	1,836
Total revenue	52,251	317	130,227	-	3,276	186,071
Expenditures						
Public works	66,242	-	-	-	-	66,242
Debt service	-	45,351	76,458	-	-	121,809
Other	-	-	-	45	-	45
Total expenditures	66,242	45,351	76,458	45	-	188,096
Excess of Revenue Over (Under) Expenditures	(13,991)	(45,034)	53,769	(45)	3,276	(2,025)
Other Financing Sources (Uses) -						
Operating transfers in	11,000	44,626	-	-	-	55,626
Net Change in Fund Balances	(2,991)	(408)	53,769	(45)	3,276	53,601
Fund Balances - Beginning of year	53,891	1,457	93,304	21,320	63,457	233,429
Fund Balances - End of year	<u>\$ 50,900</u>	<u>\$ 1,049</u>	<u>\$ 147,073</u>	<u>\$ 21,275</u>	<u>\$ 66,733</u>	<u>\$ 287,030</u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Net Assets Internal Service Funds June 30, 2007

	Equipment	Retiree Benefits	Total
Assets - Current assets - Cash and investments	<u>\$ -</u>	<u>\$ 126</u>	<u>\$ 126</u>
Net Assets - Unrestricted	<u>\$ -</u>	<u>\$ 126</u>	<u>\$ 126</u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Revenue, Expenses, and Changes in Net Assets Internal Service Funds Year Ended June 30, 2007

	Equipment	Retiree Benefits	Total
Operating Revenue - Charges for services	\$ -	\$ 89,947	\$ 89,947
Operating Expenses - Retiree benefits	<u>-</u>	<u>92,227</u>	<u>92,227</u>
Operating Loss	-	(2,280)	(2,280)
Nonoperating Revenue - Interest income	-	245	245
Other Financing Uses - Transfers out	<u>(179,949)</u>	<u>-</u>	<u>(179,949)</u>
Change in Net Assets	(179,949)	(2,035)	(181,984)
Net Assets - Beginning of year	<u>179,949</u>	<u>2,161</u>	<u>182,110</u>
Net Assets - End of year	<u><u>\$ -</u></u>	<u><u>\$ 126</u></u>	<u><u>\$ 126</u></u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Cash Flows Internal Service Funds Year Ended June 30, 2007

	Equipment	Retiree Benefits	Total
Cash Flows from Operating Activities			
Receipts from other funds	\$ -	\$ 89,947	\$ 89,947
Payments to suppliers	-	(92,227)	(92,227)
Net cash used in operating activities	-	(2,280)	(2,280)
Cash Flows from Noncapital Financing Activities -			
Transfers to other funds	(82,133)	-	(82,133)
Cash Flows from Investing Activities - Interest received on investments	-	245	245
Net Decrease in Cash and Cash Equivalents	(82,133)	(2,035)	(84,168)
Cash and Cash Equivalents - July 1, 2006	82,133	2,161	84,294
Cash and Cash Equivalents - June 30, 2007	<u>\$ -</u>	<u>\$ 126</u>	<u>\$ 126</u>
Reconciliation of Operating Loss to Net Cash from Operating Activities - Operating loss	\$ -	\$ (2,280)	\$ (2,280)
Net cash used in operating activities	<u>\$ -</u>	<u>\$ (2,280)</u>	<u>\$ (2,280)</u>



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October 30, 2007

Honorable Mayor and Members of the
City Council
City of Mt. Morris
Mt. Morris, Michigan

Dear Mayor and Council Members:

We recently completed our audit of the basic financial statements of the City of Mt. Morris for the year ended June 30, 2007. As a result of our audit, we have the following comments and recommendations for your review and consideration.

New auditing rules effective December 31, 2006 have resulted in some changes in the communications that we are required to provide following our audit. These rules require us to more formally communicate matters we note about your accounting procedures and internal controls. While we have always provided our observations in these areas as part of our audit, we are now required to tell you about more items than we may have in the past and to communicate them in writing.

The new auditing standards (Statement on Auditing Standards Number 112, referred to as SAS 112) require us to inform you about any matters noted in your accounting procedures or internal controls that the new auditing standards define as a significant deficiency. The new threshold for a significant deficiency is a low one - a significant deficiency is any flaw that creates more than a remote risk of errors in your financial statements that could matter to a user of the statements. Matters that may be immaterial to the financial statements still may be classified by the new auditing standards as a significant deficiency. For example, the requirements of SAS 112 go so far as to classify certain journal entries proposed by your auditor as a significant deficiency.

We are also required to communicate these matters to more people. In the past, we have provided our comments and observations as part of a meeting or discussion at the end of our work directly to management. Under these new rules, we are obligated to communicate these matters in writing to all individuals involved in overseeing strategic direction and accountability for your operations, including the board of trustees, in addition to our communications with management. This communication is intended to comply with the requirements of the new auditing standards.



In planning and performing our audit of the financial statements of the City of Mt. Morris as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be material weaknesses in internal control:

- **Bank Reconciliations** - During our review of the City's bank reconciliations, we noted that the treasurer prepares the reconciliations but does not sign and date them. As a result, we could not assess the timeliness of their preparation. We recommend that the treasurer sign and date the reconciliations as evidence of their timely preparation. In addition, the bank reconciliations are not reviewed. We recommend that the city manager review all bank reconciliations and sign and date them as evidence of his review. Finally, we noted that several of the bank reconciliations, mostly from early in the fiscal year, were not fully reconciled. They included large unreconciled differences. It appeared that later in the year the treasurer revised the reconciliations and was able to resolve most of the unreconciled differences; however, it is important that all bank reconciliations are properly prepared initially in order to isolate and resolve any potential issues immediately.

- **Journal Entries** - The treasurer prepares and posts all manual journal entries into the general ledger system. There is currently no review of the journal entries that the treasurer posts. We recommend that someone (clerk or city manager) review all journal entries posted to the general ledger on at least a monthly basis.
- **Cash Collection** - During our review of the cash collections process, we noted that there are times when the treasurer collects cash from citizens at the front counter. The treasurer also prepares all bank reconciliations and posts adjusting journal entries. We recommend that the treasurer be restricted from collecting cash directly.

We consider the following deficiencies to be significant deficiencies in internal control:

- **Accounting for Certificates of Deposit** - Currently, the treasurer does not account for the rollover of certificates of deposit each time they mature. While journal entries were properly recorded at year end to record interest earned and to adjust the CDs to the proper balance, these entries should be recorded throughout the year in order to ensure that interest income is properly recorded and the CD activity is properly tracked.
- **Recording of Accounts Payable** - During our testing of accounts payable, we noted that the June 2007 sewer invoice, which was paid in July 2007, had not been recorded as a payable. As a result, an audit adjustment of approximately \$16,600 was required.
- **Property Tax Remittance** - During our testing of property taxes, we noted that tax collections were not always remitted to the other taxing authorities on a timely basis. The City is required to remit property tax collections twice per month. We noted that taxes collected from the summer 2006 levy were not remitted timely.

In addition, we bring the following items, which are not considered to be significant deficiencies, to your attention:

Revenue Bond Covenants

The City is required by its Water System Revenue Bonds to maintain a reserve of balance in a restricted cash account. Currently, the balance in that restricted account is significantly higher than what is required by the bond covenants. As mentioned in the prior year, we recommend that the City perform the debt covenant calculation annually to determine proper compliance and to ensure that excess funds be made available for other purposes if desired.

Solid Waste Collection and Disposal

During April 2004, the City approved a new contract for residential solid waste collection and disposal services. On a go-forward basis, the City may want to consider calculating the cost of the service, including overhead, and compare it to the revenues generated by resident fees. Depending on the results of this calculation, the City may need to re-evaluate the fee being charged to its residents. We recommend that the City continue to perform this calculation and monitor the results.

Employee Training and Development

During the year ended June 30, 2007, the City experienced turnover amongst the most senior finance staff. The treasurer, who was promoted to the position in March 2007, is relatively inexperienced for her position. It will be important for the City to continue to devote resources to the treasurer's training and development in order to ensure that the finance function is carried out efficiently and effectively.

New Auditing Standards

Major and comprehensive changes were made to auditing rules in 2006 (June 30, 2007 year end for City of Mt. Morris). These new auditing standards require significant changes in how audits are done and how the results of the auditor's work are communicated to clients, bringing auditing rules for governmental units into closer alignment with the standards imposed on audits of public companies under Sarbanes-Oxley.

Some of these new standards became effective for audits of financial statements dated December 31, 2006 and after. As a result, auditors are required to comply with very specific rules related to the form, content, and extent of audit documentation, including more thorough documentation of auditing procedures and results. Other new guidelines affect the audit evidence that must be obtained before an auditor can consider an audit complete.

Another new rule requires auditors to more formally communicate matters they observe about their clients' accounting procedures and internal controls. Auditors are now required to inform clients about any "significant deficiencies" in accounting procedures or internal controls that come to their attention. Significant deficiency is a defined term that includes any flaw creating more than a remote risk of errors in financial statements that could reasonably matter to a user of the statements. Auditors must now communicate these matters in writing to all individuals involved in overseeing strategic direction and accountability for operations, in addition to management.

The remainder of the new rules will become effective for audits of financial statements dated December 31, 2007 and later (June 30, 2008 for the City of Mt. Morris). These new rules, which are known collectively as the new Risk Assessment Standards, significantly change the procedures auditors must perform in all financial statement audits. Under these new rules, auditors will be required to:

- More thoroughly examine and evaluate clients' accounting processes and controls, including the overall control environment, key controls over significant transactions, and the quality of internal oversight of the financial reporting process
- More thoroughly assess and document conditions in clients' systems and processes that create risks of material misstatement in their financial statements, and perform additional testing in response to these risks
- Design and perform more analytical tests of accounting and financial data

- Apply more stringent standards in identifying, assessing, and communicating internal control deficiencies
- Communicate more information about the results of the auditor's work to individuals involved in overseeing strategic direction and accountability for operations

As a practical effect of these new rules, auditors will need to make more detailed and specific requests for information from clients, particularly about processes and controls, and clients will need to do more work to be well prepared for their audits. The new rules also will require increased audit testing and more thorough auditing procedures, and will increase the amount of related documentation that auditors must prepare and maintain.

Plante & Moran, PLLC began analyzing these new standards and incorporating the necessary changes into our audit process and tools more than a year ago. It is clear that the new rules will require us to perform more audit procedures than we have in the past. Over the next several months, our firm will be investing heavily to implement our new audit methodology and train our staff on these changes. Our goal is to have our staff trained and working with our clients to prepare for the transition to these new rules well in advance of the required implementation date.

As we move forward, we will be communicating with you regularly about matters that will affect your next financial statement audit. In addition, we plan to begin to work with you during the upcoming year in a number of areas, including review and documentation of your internal accounting procedures and controls, to ensure a smooth transition to these new standards. We will be in contact with you in the near future to discuss these matters in more detail.

The primary objective of these new rules is to strengthen and enhance the independent audit of financial statements, including more thorough evaluation and information about your internal accounting and financial reporting processes and controls. We believe that these new rules, and the additional communications you will receive from us about the results of our audit work, will enhance the value you receive from your financial statement audit.

Revenue Sharing

The future of the State's revenue-sharing program continues to be directly tied to the condition of the State's budget. Reductions to statutory revenue sharing started in 2001 as shortfalls began occurring in the State's budget. The State's budget shortfalls continue to be significant. The State was approximately \$1.8 billion short of the revenue needed to cover basic services for the State's upcoming fiscal year 2007/2008 budget. The legislature and the governor acted on October 1 to increase the income tax rate (from 3.9 percent to 4.35 percent, raising more than \$750 million) and to enact a new 6 percent tax on certain services (raising approximately \$700 million per year). As part of the continuation budget that was also passed on October 1, there are still approximately \$400 million of "to-be-determined" cuts that remain to be agreed upon and announced for the fiscal year 2007/2008 budget. It is not completely clear whether the State's fiscal year 2006/2007 budget has been completely balanced as well. The outcome of other matters will also impact revenue sharing and those matters include:

- **Future of County participation in Statutory Revenue-sharing** - In 2004, the State terminated payment of statutory revenue sharing to counties (which was approximately \$182 million) but allowed counties to move their operating tax levy to July from December. Counties are required to deposit the additional monies from the earlier levy into a “reserve fund” which is to be used by the counties to replace lost statutory revenue sharing in future years. The question that remains is when the reserve funds established by counties are depleted, will counties come back into the “revenue-sharing formula” and to what extent? Will the size of the statutory pot grow to accommodate counties or will there be a shift of the same monies from cities, villages, and townships to the counties?
- **Statutory Revenue-sharing Formula Expires in 2007** - Legislative action is required on this Act for appropriations to continue into 2008 and beyond.
- **Changes to Michigan’s Tax Structure** - The Michigan single business tax has been eliminated effective December 31, 2007 which will result in the loss of \$1.9 billion from the State’s budget in 2008. In June 2007, a replacement for the single business tax - called the new Michigan business tax - was approved by the legislature. More details on this new tax structure are included below. In the overview, the plan creates a new tax structure for Michigan businesses, provides further personal property tax relief to business taxpayers, and is forecasted by the State to generate about the same revenue (\$1.9 billion) as the single business tax. Technical corrections on this recently passed law are still pending and the law is lengthy and complex. The true financial impact on the State’s budget is hard to predict. Further changes to Michigan’s tax structure were made on October 1 as described above to partially close the structural budget deficit that exists.

As introduced, the governor’s budget for fiscal year 2007/2008 includes a revenue-sharing increase of \$27 million to be distributed using the three-part formula currently contained in the revenue-sharing act (taxable value per capita, population/unit type, and yield equalization) with an additional \$14.5 million for public safety funding. While specific details have not been announced yet, communities would only be eligible for the increase if they can demonstrate service sharing with other local governments. Many observers have indicated that it is likely that revenue sharing for fiscal year 2007/2008 will more than likely be tied to fiscal year 2006/2007 funding levels.

It is unclear what the outcome will be regarding the short-term and long-term funding of statutory revenue sharing. Decisions still remain on the ultimate funding level for revenue sharing for the State’s fiscal years 2006/2007 and 2007/2008. Local governments may need to react with budget amendments when these final decisions are made by the State.

New Michigan Business Tax

As previously indicated, the new Michigan business tax (MBT) was approved by the legislature in June 2007 and replaces the single business tax (SBT) which expires December 31, 2007. According to the State, the new MBT is intended to generate about the same \$1.9 billion generated by the expiring SBT.

While the MBT intended to simplify the old SBT, the MBT is a very lengthy and complicated new law. The new MBT imposes two taxes - a modified gross receipts tax and a business income tax. The modified gross receipts tax is imposed at .8 percent on a tax base composed of gross receipts less certain purchases. The business income tax will be imposed at a rate of less than 5 percent on business income. The MBT provides for new investment, compensation, and research and development credits to businesses. The MBT also allows certain qualified small businesses to opt out of the MBT and pay a straight 1.8 percent tax on adjusted business income.

More personal property tax relief is also part of the new MBT. Business personal property classified as "industrial" or "commercial" will be exempt from certain personal property taxes - specifically from the State Education Tax (SET) and local school operating mills. "Industrial" personal property will receive exemptions from the six SET mills and the 18 schools operating mills (for a total 24 mill exemption). "Commercial" personal property will be exempt from 12 of the 18 school operating mills.

These newly enacted personal property tax exemptions will mean that local governments will collect less school taxes on these properties. For local governments that have enacted an administrative fee on tax collections, they will likely see a decrease in the administration fees that have traditionally been collected. Also, for those local governments with tax increment financing authorities that continue to have existing eligible obligations outstanding and are therefore allowed to capture school taxes (to the extent of these eligible obligations), the personal property tax exemptions on school millages will likely decrease the amount of school taxes available to capture.

Given the favorable tax treatment of industrial versus commercial personal property, it is expected that businesses will be re-reviewing the classification of their personal property. Your assessor will likely receive more frequent inquiries and requests to change classification of personal property to take the most advantage of the tax break afforded to industrial property and commercial property and the additional relief available for industrial property.

As we understand it now, these are the areas at the local governmental level (i.e., impact on administrative fees, impact on school dollars available for capture for certain tax increment financing authorities, and property classifications) that are the most directly impacted by the new MBT.

We will keep you updated as we continue to explore these and other issues regarding the impact of the MBT on local units of government.

Funding of Postemployment Benefit Obligations

As mentioned in previous years, the Governmental Accounting Standards Board has released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The pronouncement provides guidance for local units of government in recognizing the cost of retiree healthcare benefits. The intent of the new rules is to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid. These new rules will apply to the government-wide financial statements, rather than the individual fund level. As a result, the City will need to continue to budget for contributions to a pre-funding plan. For many communities, the funding of postemployment benefits is the most significant financial challenge they will face in coming years. The statement, as previously mentioned, will be effective for the City's fiscal year ending June 30, 2010. The City will need to perform an actuarial valuation during the fiscal year ending June 30, 2009 to provide an estimate as to what these annual costs may amount to. The cost of health care currently paid each year as premiums become due has been increasing and the trend is expected to continue.

Municipal Finance Act Revisions

The Municipal Finance Act was amended several years ago. Communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old 10-day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months following the end of the City's year ended June 30, 2007 and is good for one year thereafter. The City should consider the need to file a qualifying statement for each of its component units.

We would like to thank Jake LaFurgey and Vicki Fishell, as well as all of the City's personnel for their assistance during the audit. We appreciate the opportunity to serve as your auditors. If there are any questions about your financial report or the above comments and recommendations, we would be happy to discuss them at your convenience.

Very truly yours,

Plante & Moran, PLLC



David H. Helisek



Kellie L. Goines